

**REPORT OF THE AUDIT OF THE
MORGAN COUNTY
FISCAL COURT**

**For The Fiscal Year Ended
June 30, 2007**

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To the People of Kentucky

Honorable Steven L. Beshear, Governor

Jonathan Miller, Secretary

Finance and Administration Cabinet

Honorable Tim Conley, Morgan County Judge/Executive

Members of the Morgan County Fiscal Court

Independent Auditors' Report

We have audited the accompanying financial statements of the governmental activities and each major fund of Morgan County, Kentucky, as of and for the year ended June 30, 2007, which collectively comprise the County's basic financial statements, as listed in the table of contents. These financial statements are the responsibility of the Morgan County Fiscal Court. Our responsibility is to express opinions on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America, the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, and the *Audit Guide for Fiscal Court Audits* issued by the Auditor of Public Accounts, Commonwealth of Kentucky. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and the significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinions.

As discussed in Note 1, Morgan County, Kentucky, prepares its financial statements on a prescribed basis of accounting that demonstrates compliance with the modified cash basis, which is a comprehensive basis of accounting other than accounting principles generally accepted in the United States of America.

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position-modified cash basis of the governmental activities and each major fund of Morgan County, Kentucky, as of June 30, 2007, and the respective changes in financial position-modified cash basis, thereof for the year ended in conformity with the basis of accounting described in Note 1.

To the People of Kentucky
Honorable Steven L. Beshear, Governor
Jonathan Miller, Secretary
Finance and Administration Cabinet
Honorable Tim Conley, Morgan County Judge/Executive
Members of the Morgan County Fiscal Court

In accordance with *Government Auditing Standards*, we have also issued our report dated September 21, 2007, on our consideration of the Morgan County Fiscal Court's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

The management's discussion and analysis and budgetary comparison information are not a required part of the basic financial statements but are supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise Morgan County, Kentucky's basic financial statements. The accompanying schedule of expenditures of federal awards is presented for purposes of additional analysis as required by U.S. Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, and is not a required part of the basic financial statements. The schedule of expenditures of federal awards has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

Based on the results of our audit, we present the schedule of findings and questioned costs, included herein, which discusses the following report comments:

- 2007-1 The County Should Provide Retirement Compensation To All Employees That Work An Average Of 100 Hours Per Month
- 2007-2 The County Should Pay Invoices Within Thirty Days Of Receipt Of A Vendor's Invoice
- 2007-3 The County Should Make Contractors Aware Of All Compliance Requirements Associated With Project Funding
- 2007-4 The County Should Pay All Debt Expenditures Timely

Respectfully submitted,

Morgan - Franklin, LLC

Morgan-Franklin, LLC

September 21, 2007

MORGAN COUNTY OFFICIALS

For The Fiscal Year Ended June 30, 2007

Fiscal Court Members:

Tim Conley	County Judge/Executive
Randy Cantrell	Magistrate
Denzil Potter	Magistrate
Frankie Spencer	Magistrate
Burton Stacy	Magistrate
Stanley Rigsby	Magistrate

Other Elected Officials:

Steve O'Connor	County Attorney
Jimmy D. Easterling	Jailer
Randy Williams	County Clerk
Donna Pelfrey	Circuit Court Clerk
Mickey Whitt	Sheriff
Vacant	Property Valuation Administrator
Marling Potter	Coroner

Appointed Personnel:

Tommy Phipps	County Treasurer
Lynn McClurg	Road Supervisor

Morgan County, Kentucky
Management's Discussion and Analysis
For the Year Ended June 30, 2007
Unaudited

The discussion and analysis of Morgan County's financial performance provides an overview of the County's financial activities for the fiscal year ended June 30, 2007. The intent of this discussion and analysis is to look at the County's financial performance as a whole.

Financial Highlights

Key financial highlights for 2007 are as follows:

The County's total net assets increased by \$537 thousand, which represents a 3.8% increase from 2006. While total assets increased 1% total capital assets increased \$217 thousand or 1.11% reflective of expenditures in the bridge and paved road categories of \$345 thousand and \$517 thousand.

The County's long term liabilities decreased \$41 thousand, which is reflective of the County's normal scheduled debt principal payments. Current liabilities of \$391 thousand represent a 41.3% decrease from 2006 with \$391 thousand representing the debt principal and interest payments for 2008 a \$95 thousand increase over 2006.

At the end of the current fiscal year, the County's combined fund cash balance was \$235 thousand, a decrease of \$66 thousand or 21.8% from the prior year. Of the \$235 thousand carry over \$205 thousand is allocated to specific projects which are incorporated into the County's fiscal year 2008 budget leaving a cash balance carry forward of \$30 thousand.

Overview of the Financial Statements

This annual report consists of a series of financial statements. These statements are organized so the reader can understand the County as a financial whole or as an entire operating entity. The statements also provide a detailed look at specific financial conditions.

The County's basic financial statements are comprised of three components: the County's financial statements, fund financial statements, and notes to the financial statements. This report also contains other supplementary information in addition to basic financial statements themselves.

County's Financial Statements

The County's financial statements are designed to provide readers with a broad overview of the County's finances, in a manner similar to a private-sector business.

Statement of Net Assets and Statement of Activities

The statement of net assets presents information on all of the County's assets and liabilities, with the difference between the two reported as net assets. The statement of activities presents information showing how the County's net assets changed during the current year. These statements are prepared using the modified cash basis of accounting similar to the accounting method used by private sector companies. This basis of accounting takes into consideration all of the current year's revenues and expenses when the cash is received or paid.

The change in net assets is important because it tells the reader whether, for the County as a whole, the financial position of the County has improved or diminished. However, in evaluating the overall position of the County, nonfinancial information such as changes in the County's tax base and the condition of the County's capital assets will also need to be evaluated.

In the statement of net assets and the statement of activities, the County is divided into several major expenditure categories:

Expenditure Category
General Government
Protection to Persons & Property
Health and Sanitation
Social Services
Recreation and Culture
Roads
Debt Service
Capital Projects
Administration

Fund Financial Statements

A fund is a grouping of related accounts that is used to maintain control over resources that have been segregated for specific activities or objects. The County, like other state and local governments, uses fund accounting to ensure and demonstrate compliance with finance related legal requirements. Fund financial statements provide detail information about the County's major funds. Based on the restriction on the use of moneys as set forth in the County's annual budget, the County has established many funds that account for the multitude of services provided to our citizens. The County's major governmental funds are the general fund, road fund, jail fund, local government economic assistance fund and timberland-taxing fund.

Governmental Funds – Governmental funds are used to account for essentially the same functions reported as governmental activities on the government wide financial statements. Most of the County's basic services are reported in these funds that focus on how money flows into and out of the funds and the year-end balances available for spending. These funds are reported on a modified cash basis of accounting meaning that all revenues are recognized when received all expenditures recognized when paid. The governmental funds statements provide a detailed short-term view of the County's general governmental operations and the basic services being provided, along with the financial resources available.

Because of the focus of the governmental funds is narrower than that of the government-wide financial statements, it is useful to compare the information presented for governmental funds with similar information presented for governmental activities on the government wide financial statements. By doing so, readers may better understand the long-term effect of the government's short term financing decisions. Both the governmental fund balance sheet and the governmental fund statement of revenues, expenditures, and changes in fund balances provide a reconciliation to facilitate this comparison between governmental funds and governmental activities.

The County maintains several individual governmental funds. Information is presented separately on the governmental fund balance sheet and on the governmental fund statement of revenues, expenditures and changes in fund balances for the major funds, which were identified earlier. Data from the other governmental funds are combined into a single aggregate presentation, if applicable.

Notes to the financial statements – The notes provide additional information that is essential to a full understanding of the data provided on the government wide and fund financial statements.

Other information – In addition to the basic financial statements and accompanying notes, this report also presents combined and individual fund statements and schedules.

Government Wide Financial Analysis

Table 1 provides a summary of the County's net assets for 2007 compared to 2006 as well as the changes in net assets for 2007:

MORGAN COUNTY FISCAL COURT Balance Sheet Comparison FY 2006 and FY 2007

Assets:	FY 2006	FY 2007	\$ Difference	% Difference
Total Fund Cash Balance	300,713.03	235,070.01	(65,643.02)	-21.83%
Receivable From Ambulance Service	60,153.00	70,071.00	9,918.00	16.49%
Total Capital Assets	<u>19,409,434.58</u>	<u>19,626,160.00</u>	<u>216,725.42</u>	<u>1.12%</u>
Total Assets	19,770,300.61	19,931,301.01	161,000.40	0.81%
Liabilities:				
Current & Other Liabilities	665,698.82	390,738.00	(274,960.82)	-41.30%
Long Term Liabilities	<u>4,801,812.12</u>	<u>4,760,525.00</u>	<u>(41,287.12)</u>	<u>-0.86%</u>
Total Liabilities	<u>5,467,510.94</u>	<u>5,151,263.00</u>	<u>(316,247.94)</u>	<u>-5.78%</u>
Total Net Assets	<u>14,302,789.67</u>	<u>14,780,038.01</u>	<u>477,248.34</u>	<u>3.34%</u>

As noted earlier, the County's net assets, when reviewed over time, may serve as a useful indicator of the County's financial position. In the case of the County, assets exceeded liabilities by \$14,780 thousand as of June 30, 2007 and \$14,303 thousand as of June 30, 2006 an increase of \$477 thousand or 3.34%. The largest component of the County's assets is capital assets at \$19,626 thousand or 98.4% of total assets. These assets represent investment in land, buildings, roads, road improvements, bridges, land improvements, vehicles, and equipment. These assets are used to provide services to the citizens of the county and consequently these assets are not available for future spending. Related to the capital assets are liabilities in the amount of \$5,151 thousand. Net of the related debt the County's capital assets would be \$14,475 thousand. It should be noted that the resources needed to repay the debt must be provided from other sources since the capital assets themselves cannot be used to liquidate these liabilities. At year end \$205 thousand of net assets or 1.39% of the County's total net assets are restricted to specific capital projects and other general governmental activities.

The changes in total cash funds for 2007 are detailed in the cash flow analysis table. Total net assets decreased \$477 thousand or 3.34% over the previous year. Fund cash balances decreased \$65 thousand over the previous year.

Cash Flow Analysis

The following table analyzes the net changes in cash for fiscal year 2006 and fiscal year 2007.

MORGAN COUNTY FISCAL COURT		
Change in Cash Comparison FY 2006 and FY 2007		
	FY 2006	FY 2007
Revenues:		
Property Taxes	567,569.85	608,215.58
Other Taxes	41,840.83	47,963.80
Excess Fees	34,348.85	15,120.86
Licenses / Permits	865.95	2,576.98
State Grants	3,452,208.38	5,281,482.67
Intergovernmental	224,984.23	277,080.04
Interest	153,127.69	5,853.73
Other	29,688.21	230,633.27
Total Revenue	4,504,633.99	6,468,926.93
Transfers		
Expenditures:		
General Government	731,266.37	694,485.00
Protection to Persons & Property	489,469.82	531,898.52
Health & Sanitation	157,698.06	118,527.70
Social Services	5,000.00	5,000.00
Recreation & Culture	660.00	1,460.00
Transportation Facilities	5,006.83	-
Roads	669,722.75	612,771.42
Airports	-	-
Debt Service	656,444.58	635,170.69
Capital Projects	1,931,808.92	3,417,314.20
General Services	53,692.48	67,456.26
Fringe Benefits	489,597.60	454,437.25
Distributions to Other Gov't Agencies	6,660.92	9,571.90
Total Expenditures	5,197,028.33	6,548,092.94
Increase (Decrease) In Net Cash	(692,394.34)	(79,166.01)
Cash Balance Beginning of Year	993,107.37	314,236.02
Cash Balance End of Year	300,713.03	235,070.01

For fiscal year 2006 the County's cash reserves decreased by \$692 thousand and for fiscal year 2007 the County's cash reserves decreased by \$79 thousand. Total revenues increased \$1,914 thousand from 2006 to 2007 attributed mostly to the increase in state grant revenue of \$1,829 thousand and an increase in intergovernmental revenue of \$52 thousand.

Total expenditures increased by \$1,351 thousand from 2006 to 2007. While expenditures in several categories decreased from 2006 to 2007, there was an increase of \$1,485 thousand in capital projects related to the sewer expansion project and the bridge replacement program.

The following table analyzes the change in fund balance by fund for 2007:

MORGAN COUNTY FISCAL COURT
Statement of Revenues Expenditures and Change in Fund Balance 2007

	General Fund	Road Fund	Jail Fund	LGEA Fund	Timberland Taxing Fund	Totals
Fund Balance Beginning of Year	245,400.21	68,790.35	45.46	-	-	314,236.02
Revenue Receipts	3,945,339.83	2,151,513.26	76,662.87	242,663.00	2,747.97	6,418,926.93
Interfund Transfers In	186,790.00	45,051.14	291,511.54	-		523,352.68
Interfund Transfers (Out)	94,000.00	186,790.00		242,562.68		523,352.68
General Government Expenditures	694,485.00	-				694,485.00
Protection to Persons & Property Expenditures	142,777.24	-	336,464.80		2,656.48	481,898.52
General Health & Sanitation Expenditures	118,527.70	-				118,527.70
Social Services	5,000.00					5,000.00
Airport Expenditures		-				-
Roads & Transportation Expenditures		612,771.42				612,771.42
Capital Project Expenditures	2,554,572.30	862,741.90				3,417,314.20
Recreation & Culture Expenditures	1,460.00	-				1,460.00
Debt Service Expenditures	246,372.89	388,797.80				635,170.69
Financial Administration Expenditures	297,960.44	211,307.99	22,196.98			531,465.41
Fund Balance End of Year	222,374.47	2,945.64	9,558.09	100.32	91.49	235,070.01
Change in Fund Balance	(23,025.74)	(65,844.71)	9,512.63	100.32	91.49	(79,166.01)

The decrease in fund balance of \$79 thousand is largely due to the road fund decrease in fund balance of \$66 thousand. The road fund decrease represents 83.1% of the overall fund balance decrease for the year.

Budgetary Highlights

By statute, the fiscal court adopts an annual operating budget for the County before the first day of each new fiscal year. The budget is reviewed as to form classification and content by the Governor's Office for Local Development in Frankfort prior to final adoption by the County. As necessary the budget is amended by the County through an ordinance process to include unanticipated revenues, distributing those revenues to various appropriation line items or placing unanticipated revenues in reserve accounts. The fiscal court makes line item appropriation transfers throughout the fiscal year to keep appropriation line items properly funded.

Current & Other Liabilities

The \$788 thousand in the current and other liabilities for 2007 includes \$104 thousand of unpaid bills. The vast majority of bills are paid subsequent to each meeting of the Fiscal Court, which meets the second Wednesday of each month. Therefore, at the end of any month throughout the year the County will have varying amounts of bills unpaid. However, due to remarkable cash shortages because of revenue shortfalls and excessive expenditures the County has an inordinate amount of unpaid bills, some close to 2 months in arrears. These unpaid bills are also reported with the County's quarterly financial reports to the Governor's Office for Local Development.

Long Term Debt

The County has assumed a certain level of long term debt to finance activities such as building construction, road surfacing, road equipment and vehicles. The Kentucky Association of Counties Leasing Trust in Frankfort provides this long term financing to the County. At the end of 2006 the level of long term debt was \$5,498 thousand and at the end of 2007 was \$5,151 thousand. Details of the County's long term debt follow:

Description	Year End Balance	Rate of Interest	Maturity Date
Road Blacktop Projects	\$1,831,717	4.25%	06/28/2020
Road Blacktop Projects	\$1,196,871	4.25%	12/01/2020
Morgan Co. Library	\$1,746,903	4.64%	01/20/2021
Road Equipment	\$234,000	3.94%	01/20/2011
Ambulance Lease	\$27,071	4.25%	04/20/2009
Ambulance Lease	\$43,000	4.74%	11/20/2010
Vehicle & Mowing Equipment	\$71,621	4.25%	05/20/2009
Total	\$5,151,183		

It should be noted that because of a cash shortage in the road fund, the June 2007 lease payments of \$16 thousand were not paid when due.

During the year the County paid \$402 thousand on principal reduction and \$266 thousand in interest payments. The County incurred \$50 thousand of new debt during the year.

Concerning the debt for the Morgan Co. Library, the County receives an annual grant of \$183 thousand from the State, which is used to fund the debt service for the Library.

The Morgan County Fiscal Court also has a lease agreement with Fifth Third Leasing. The balance of the lease is \$6,691 as of June 30, 2007. The lease will mature in May 2008 and at that time, the county has the option to purchase this vehicle per the terms of the executed lease. Additional information on the County's long-term debt can be found in Note 4 of this report.

Capital Assets

An analysis of the changes in the County's capital assets is shown in the table below:

MORGAN COUNTY FISCAL COURT Analysis of Capital Assets for 2006 and 2007

	2006	2007	Difference
Bridges			
Depreciable Cost	2,563,490	2,908,490	345,000
Accumulated Depreciation	(343,744)	(386,504)	(42,760)
Net Value of Bridges	2,219,746	2,521,986	302,240
 Paved Roads			
Depreciable Cost	7,083,576	7,600,400	516,823
Accumulated Depreciation	(2,363,016)	(2,747,237)	(384,222)
Net Value of Paved Roads	4,720,561	4,853,162	132,602
 Road Projects			
Depreciable Cost	67,363	67,363	-
Accumulated Depreciation	(4,365)	(5,880)	(1,515)
Net Value of Road Projects	62,998	61,483	(1,515)
 Land			
Cost	2,222,164	2,272,164	50,000
Net Value of Land	2,222,164	2,272,164	50,000
 Equipment & Vehicles			
Depreciable Cost	1,307,092	1,322,508	37,761
Accumulated Depreciation	(351,362)	(520,745)	(174,257)
Net Value of Equipment & Vehicles	955,730	801,763	(136,496)
 Land Improvements			
Depreciable Cost	2,157,555	2,157,555	-
Accumulated Depreciation	(334,914)	(388,682)	(53,768)
Net Value of Land Improvements	1,822,641	1,768,873	(53,768)
 Buildings			

Depreciable Cost	9,357,608	9,457,608	100,000
Accumulated Depreciation	(1,976,108)	(2,188,978)	(212,869)
Net Value of Buildings	7,381,499	7,268,630	(112,869)
Furnishings			
Depreciable Cost	28,264	32,770	4,506
Accumulated Depreciation	(4,168)	(7,016)	(2,848)
Net Value of Furnishings	24,097	25,755	1,658
Construction In Progress			
Current Cost	-	52,345	52,345
Total Depreciable Cost	24,787,112	25,871,202	1,084,090
Total Accumulated Depreciation	(5,377,677)	(6,245,042)	(867,365)
Net Value	19,409,435	19,626,160	216,725

The total depreciable cost increased by \$1,084 for 2007 an increase of 4.37%. Nearly all categories of assets increased during 2007 including bridges \$345 thousand, paved roads \$517 thousand, and land \$50 thousand. Construction in progress increased by \$52 thousand, which represents expenditures on the bridge design for which the actual bridge construction has not been completed. Accumulated depreciation increased by \$867 thousand for the year. Net capital asset values increased by \$217 thousand for the year.

Depreciation is taken on a straight-line basis for all capital assets except land, which is not depreciated. Depending upon the class of asset, depreciation is taken over various assets lives with varying amounts of salvage value attributed to the various classes of assets at the end of their useful lives. As an example buildings have a useful life of 40 years generally speaking with a 10% of original cost as a salvage value. Additional information on the County's capital assets can be found in Note 3 of this report.

Requests for Information

This financial report is designed to provide a general overview of the County's finances. Questions concerning any of the information provided in this report or requests for additional information should be addressed to the Morgan County Treasurer, 450 Prestonsburg Street, West Liberty, KY 41472.

MORGAN COUNTY
STATEMENT OF NET ASSETS - MODIFIED CASH BASIS

June 30, 2007

MORGAN COUNTY
STATEMENT OF NET ASSETS - MODIFIED CASH BASIS
JUNE 30, 2007

	<u>Primary Government</u> <u>Governmental</u> <u>Activities</u>
ASSETS	
Current Assets:	
Cash and Cash Equivalents	\$ 235,070
Receivable from Ambulance Service	31,798
Total Current Assets	<u>266,868</u>
Noncurrent Assets:	
Receivable from Ambulance Service	38,273
Capital Assets - Net of Accumulated Depreciation:	
Construction In Progress	52,345
Land and Land Improvements	4,041,001
Buildings	7,268,484
Furnishings	25,754
Vehicles and Equipment	801,762
Infrastructure Assets - Net of Depreciation	<u>7,437,279</u>
Total Noncurrent Assets	<u>19,664,898</u>
Total Assets	19,931,766
LIABILITIES	
Current Liabilities:	
Financing Obligations	390,738
Noncurrent Liabilities:	
Financing Obligations	<u>4,760,525</u>
Total Liabilities	<u>5,151,263</u>
NET ASSETS	
Invested In Capital Assets, Net of Related Debt	14,475,362
Restricted	
Debt Service Ambulance Service	70,071
Unrestricted	<u>235,070</u>
Total Net Assets	<u><u>\$ 14,780,503</u></u>

The accompanying notes are an integral part of the financial statements.

**MORGAN COUNTY
STATEMENT OF ACTIVITIES – MODIFIED CASH BASIS**

For The Year Ended June 30, 2007

MORGAN COUNTY
STATEMENT OF ACTIVITIES - MODIFIED CASH BASIS
For The Year Ended June 30, 2007

Functions/Programs	Expenses	Program Revenues Received			Net (Expenses) Revenues and Changes in Net Assets
		Charges for Services	Operating Grants and Contributions	Capital Grants and Contributions	Total
					Governmental Activities
Primary Government:					
Governmental Activities:					
General Government	\$ 1,410,229	\$ 145,151	\$ 599,040	\$ 2,411,718	\$ 1,745,680
Protection to Persons and Property	546,142	3,669	72,865		(469,608)
General Health and Sanitation	157,713				(157,713)
Social Services	5,000				(5,000)
Recreation and Culture	55,107				(55,107)
Roads	1,074,676	160,000	1,303,682		389,006
Debt Service	266,109				(266,109)
Capital Projects	2,369,363			890,417	(1,478,946)
Total Governmental Activities	<u>5,884,339</u>	<u>308,820</u>	<u>1,975,587</u>	<u>3,302,135</u>	<u>(297,797)</u>
 Total Primary Government	 <u>\$ 5,884,339</u>	 <u>\$ 308,820</u>	 <u>\$ 1,975,587</u>	 <u>\$ 3,302,135</u>	 <u>\$ (297,797)</u>
 General Revenues:					
Taxes					
Real Estate Taxes					\$ 159,120
Tangible Personal Property Tax					12,180
Motor Vehicle Taxes					57,728
Bank Deposit Franchise Fees					29,428
Franchise Fees					16,885
Insurance Premium Taxes					175,833
E-911 Surcharges					55,081
Solid Waste Fees					78,900
Other Taxes					23,062
Licenses and Permits					2,577
In Lieu Tax Payments					47,964
Excess Fees					15,121
Miscellaneous Revenues					116,821
Interest Earned					<u>5,854</u>
Total General Revenues					<u>796,554</u>
 Change in Net Assets					 498,757
Net Assets - Beginning (Restated)					<u>14,281,746</u>
Net Assets - Ending					<u>\$ 14,780,503</u>

The accompanying notes are an integral part of the financial statements.

MORGAN COUNTY
BALANCE SHEET – GOVERNMENTAL FUNDS – MODIFIED CASH BASIS

June 30, 2007

MORGAN COUNTY
BALANCE SHEET - GOVERNMENTAL FUNDS - MODIFIED CASH BASIS
June 30, 2007

	General Fund	Road Fund	Jail Fund	Local Government Economic Assistance Fund	Forestry Fund	Total Governmental Funds
ASSETS						
Cash and Cash Equivalents	\$ 222,374	\$ 2,946	\$ 9,558	\$ 100	\$ 92	\$ 235,070
TOTAL ASSETS	<u>\$ 222,374</u>	<u>\$ 2,946</u>	<u>\$ 9,558</u>	<u>\$ 100</u>	<u>\$ 92</u>	<u>\$ 235,070</u>
FUND BALANCES						
Fund Balances:						
Reserved For Encumbrances	\$ 4,353	\$ 40,380	\$ 58,976	\$	\$	\$ 103,709
Unreserved						
General Fund	218,021					218,021
Special Revenue Funds		(37,434)	(49,418)	100	92	(86,660)
TOTAL FUND BALANCES	<u>\$ 222,374</u>	<u>\$ 2,946</u>	<u>\$ 9,558</u>	<u>\$ 100</u>	<u>\$ 92</u>	<u>\$ 235,070</u>

**Reconciliation of the Balance Sheet - Governmental
Funds to the Statement of Net Assets:**

Total Governmental Fund Balances	\$ 235,070
Amounts Reported for Governmental Activities in the Statement of Net Assets are Different because:	
Capital Assets Used in Governmental Activities of \$25,871,201, Net of Accumulated Depreciation of \$6,244,576, are not Financial Resources and, Therefore, are not Reported in the Funds.	19,626,625
Notes Receivable Due from Ambulance Service for Financing Obligations	70,071
Liabilities:	
Due Within One Year - Lease Principal Payments	(390,738)
Due In More Than One Year - Lease Principal Payments	<u>(4,760,525)</u>
Net Assets of Governmental Activities	<u>\$ 14,780,503</u>

The accompanying notes are an integral part of the financial statements.

MORGAN COUNTY
STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES
IN FUND BALANCES – GOVERNMENTAL FUNDS – MODIFIED CASH BASIS

For The Year Ended June 30, 2007

MORGAN COUNTY
STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES
IN FUND BALANCES - GOVERNMENTAL FUNDS - MODIFIED CASH BASIS
For The Year Ended June 30, 2007

	General Fund	Road Fund	Jail Fund	Local Government Economic Assistance Fund	Forestry Fund	Total Governmental Funds
REVENUES						
Taxes	\$ 605,479	\$	\$	\$	\$ 2,737	\$ 608,216
In Lieu Tax Payments	28,820	19,144				47,964
Excess Fees	15,121					15,121
Licenses and Permits	2,577					2,577
Intergovernmental	3,010,851	1,951,718	76,534	242,380		5,281,483
Charges for Services	117,080	160,000				277,080
Miscellaneous	161,903	18,670	61			180,634
Interest	3,510	1,982	67	283	11	5,853
Total Revenues	3,945,341	2,151,514	76,662	242,663	2,748	6,418,928
EXPENDITURES						
General Government	694,485					694,485
Protection to Persons and Property	192,777		336,465		2,656	531,898
General Health and Sanitation	118,530					118,530
Social Services	5,000					5,000
Recreation and Culture	1,460					1,460
Roads		612,771				612,771
Debt Service	273,873	388,798				662,671
Capital Projects	2,527,072	862,742				3,389,814
Administration	297,960	211,308	22,197			531,465
Total Expenditures	4,111,157	2,075,619	358,662	0	2,656	6,548,094
Excess (Deficiency) of Revenues Over Expenditures Before Transfers and Other Financing Sources (Uses)	(165,816)	75,895	(282,000)	242,663	92	(129,166)
TRANSFERS & OTHER FINANCING SOURCES (USES)						
Lease Proceeds	50,000					50,000
Transfers from Other Funds	186,790	45,051	291,512			523,353
Transfers to Other Funds	(94,000)	(186,790)		(242,563)		(523,353)
Total Other Financial Sources (Uses)	142,790	(141,739)	291,512	(242,563)	0	50,000
Net Change In Fund Balances	(23,026)	(65,844)	9,512	100	92	(79,166)
Fund Balances, Beginning (Restated)	245,400	68,790	46			314,236
Fund Balances, Ending	\$ 222,374	\$ 2,946	\$ 9,558	\$ 100	\$ 92	\$ 235,070

The accompanying notes are an integral part of the financial statements.

**MORGAN COUNTY
RECONCILIATION OF THE STATEMENT OF REVENUES,
EXPENDITURES, AND CHANGES IN FUND BALANCES OF
GOVERNMENTAL FUNDS TO THE STATEMENT OF ACTIVITIES
MODIFIED CASH BASIS**

For The Year Ended June 30, 2007

MORGAN COUNTY
RECONCILIATION OF THE STATEMENT OF REVENUES, EXPENDITURES, AND
CHANGES IN FUND BALANCES OF GOVERNMENTAL FUNDS TO THE
STATEMENT OF ACTIVITIES - MODIFIED CASH BASIS
For The Year Ended June 30, 2007

Reconciliation to the Statement of Activities:

Net Change in Fund Balances-Total Governmental Funds	\$ (79,166)
Governmental Funds Report Capital Outlays as Expenditures. However, in the Statement of Activities, the Cost of Those Assets is Allocated Over Their Estimated Useful Lives and Reported as Depreciation Expense:	
Capital Outlay	1,084,090
Depreciation Expense	(866,900)
The Issuance of Long-term Debt Provides Current Financial Resources to Governmental Funds. These Transactions, However, Have no Effect on Net Assets:	
Lease Proceeds	(50,000)
Notes Receivable Principal Received is Recorded in the Funds as Revenue, However in the Government-Wide Financial Statements it Results in an Increase in Cash and Decrease in Notes Receivable Which has no Effect on Net Assets.	
Payment on Notes Receivable	(35,830)
Increase in Notes Receivable	50,000
Repayment of Debt Principal is an Expenditure in the Governmental Funds, but the Repayment Reduces Long-term Liabilities in the Statement of Net Assets:	
Capital Debt Obligation Principal Payments	396,562
Rounding Difference	<u>1</u>
Change in Net Assets of Governmental Activities	<u>\$ 498,757</u>

The accompanying notes are an integral part of the financial statements.

MORGAN COUNTY
NOTES TO FINANCIAL STATEMENTS

June 30, 2007

Note 1. Summary of Significant Accounting Policies

A. Basis of Presentation

The county presents its government wide and fund financial statements utilizing a modified cash basis of accounting, which is a comprehensive basis of accounting other than accounting principles generally accepted in the United States of America. Under this basis of accounting, assets, liabilities, and related revenues and expenditures are recorded when they result from cash transactions, with a few exceptions. This modified cash basis recognizes revenues when received and expenditures when paid. Property tax receivables, accounts payable, compensated absences, and donated assets, among other items are not reflected in the financial statements.

Encumbrances lapse at year-end and are not reflected on the Statement of Net Assets and Statement of Activities; however encumbrances are reflected on the Balance Sheet – Governmental Funds as part of the fund balance (Reserved for Encumbrances).

The State Local Finance Officer does not require the county to report capital assets and infrastructure; however the value of these assets are included in the Statement of Net Assets and their corresponding depreciation expense is included on the Statement of Activities.

B. Reporting Entity

The financial statements of Morgan County include the funds, agencies, boards, and entities for which the fiscal court is financially accountable. Financial accountability, as defined by Section 2100 of the Governmental Auditing Standards Board (GASB) Codification of Governmental Accounting and Financial Reporting Standards, as amended by GASB 14 and GASB 39, was determined on the basis of the government's ability to significantly influence operations, select the governing authority, participate in fiscal management and the scope of public service. Consequently, the reporting entity includes organizations that are legally separate from the primary government. Legally separate organizations are reported as component units if either the county is financially accountable or the organization's exclusion would cause the county's financial statements to be misleading or incomplete. Component units may be blended or discretely presented. Blended component units either provide their services exclusively or almost entirely to the primary government, or their governing bodies are substantively the same as the primary government. All other component units are discretely presented. Based upon the application of the criteria stated in GASB 14, and GASB 39, there are no component units which merit consideration as part of the reporting entity.

Blended Component Unit

Morgan County Public Properties Corporation

The Morgan County Fiscal Court appoints a voting majority of the Public Properties Corporation's governing board and has the ability to impose its will on the governing board. In addition, the fiscal court is financially accountable and legally obligated for the debt of the Public Properties Corporation. During the fiscal year ended June 30, 2007, the Public Properties Corporation did not have any activity to reflect in the financial statements.

MORGAN COUNTY
NOTES TO FINANCIAL STATEMENTS

June 30, 2007

Note 1. Summary of Significant Accounting Policies (Continued)

C. Morgan County Constitutional Elected Officials

Kentucky law provides for election of the below officials from the geographic area constituting Morgan County. Pursuant to state statute, these officials perform various services for the Commonwealth of Kentucky, its judicial courts, the fiscal court, various cities and special districts within the county, and the board of education. In exercising these responsibilities, however, they are required to comply with state laws. Audits of their financial statements are issued separately and individually and can be obtained from their respective administrative offices. These financial statements are not required to be included in the financial statements of Morgan County, Kentucky.

Circuit Court Clerk
County Attorney
Property Valuation Administrator
County Clerk
County Sheriff

D. Property Tax Calendar

Generally, and accept as otherwise provided by law, property taxes are assessed as of January 1, levied (mailed) November 1, due at discount November 30, due at face value December 31, delinquent January 1 following the assessment, and subject to lien and sale the 3rd Saturday in April following the delinquency date

E. Government-Wide and Fund Financial Statements

The government-wide financial statements (i.e., the statement of net assets and the statement of activities) report information on all of the non-fiduciary activities of the primary government and its non-fiduciary component units. For the most part, the effect of interfund activities has been removed from these statements. Governmental activities, which normally are supported by taxes and intergovernmental revenues, are reported separately from business-type activities, which rely to a significant extent on sales, fees, and charges for support. Business-type revenues come mostly from fees charged to external parties for goods or services. Fiduciary funds are not included in these financial statements due to the unavailability of fiduciary funds to aid in the support of government programs.

The statement of net assets presents the reporting entity's non-fiduciary assets and liabilities, the difference between the two is being reported as net assets. Net assets are reported in three categories: 1) invested in capital assets, net of related debt - consisting of capital assets, net of accumulated depreciation and reduced by outstanding balances for debt related to the acquisition, construction, or improvement of those assets; 2) restricted net assets - resulting from constraints placed on net assets by creditors, grantors, contributors, and other external parties, including those constraints imposed by law through constitutional provisions or enabling legislation; 3) unrestricted net assets - those assets that do not meet the definition of restricted net assets or invested in capital assets.

MORGAN COUNTY
NOTES TO FINANCIAL STATEMENTS

June 30, 2007

Note 1. Summary of Significant Accounting Policies (Continued)

E. Government-Wide and Fund Financial Statements (Continued)

The statement of activities demonstrates the degree to which the direct expenses of a given function are offset by program revenues. Direct expenses are those that are clearly identifiable with a specific function. Program revenues include 1) charges to customers or applicants who purchase, use, or directly benefit from goods, services, or privileges provided by a given function 2) operating grants and contributions and 3) capital grants and contributions that are restricted to meeting the operational or capital requirements of a particular function. Internally dedicated resources such as taxes and unrestricted state funds are reported as general revenues.

Funds are characterized as either major or non-major funds. Major funds are those funds whose assets, liabilities, revenues, or expenditures/expenses are at least ten percent of the corresponding total (assets, liabilities, etc.) for all funds or type (governmental or proprietary funds) and whose total assets, liabilities, revenues, or expenditures/expenses are at least five percent of the corresponding total for all governmental and enterprise funds combined. The fiscal court may also designate any fund as a major fund.

Separate financial statements are provided for governmental funds. Major individual governmental funds are reported as separate columns in the financial statements.

Governmental Funds

All governmental fund statements are reported using the current financial resources measurement focus and the modified cash basis of accounting. The modified cash basis recognizes revenues when received and expenditures when paid. Property tax receivables, accounts payable, compensated absences, and donated assets are not reflected in the financial statements.

The primary government reports the following major governmental funds:

General Fund - This is the primary operating fund of the fiscal court. It accounts for all financial resources of the general government, except where the Governor's Office for Local Development requires a separate fund or where management requires that a separate fund be used for some function.

Road Fund - This fund is for road and bridge construction and repair. The primary source of revenue for this fund is state payments for truck licenses distribution, municipal road aid, and transportation grants. The Governor's Office for Local Development requires the fiscal court to maintain these receipts and expenditures separately from the General Fund.

Jail Fund - The primary purpose of this fund is to account for the jail expenses of the county. The primary sources of revenue for this fund are reimbursements from the state and federal government, payments from other counties for housing prisoners, and transfers from the General Fund. The Governor's Office for Local Development requires the fiscal court to maintain these receipts and expenditures separately from the General Fund.

MORGAN COUNTY
NOTES TO FINANCIAL STATEMENTS

June 30, 2007

Note 1. Summary of Significant Accounting Policies (Continued)

E. Government-Wide and Fund Financial Statements (Continued)

Local Government Economic Assistance Fund – These funds may be spent for public safety, environmental protection, public transportation, health, recreation, libraries, social services, industrial and economic development, workforce training, and secondary wood industry development. In no event shall these funds be used for expenses relating to the administration of government. The Governor's Office for Local Development requires the Fiscal Court to maintain these receipts and expenditures separately from the General Fund.

Forestry Fund – The primary purpose of this fund is to account for funds received from timberland taxes.

Management has determined all funds to be major funds; therefore, there are no non-major funds.

Special Revenue Funds

The Road Fund, Jail Fund, Local Government Economic Assistance Fund, and Forestry Fund are presented as Special Revenue Funds. Special Revenue Funds are to account for the proceeds of specific revenue sources and expenditures that are legally restricted for a specific purpose.

F. Deposits and Investments

The government's cash and cash equivalents are considered to be cash on hand, demand deposits, certificate of deposits, and short-term investments with original maturities of three months or less from the date of acquisition. KRS 66.480 authorizes the county to invest in the following, including but not limited to, obligations of the United States and of its agencies and instrumentalities, obligations and contracts for future delivery or purchase of obligations backed by the full faith and credit of the United States, obligations of any corporation of the United States government, bonds or certificates of indebtedness of this state, and certificates of deposit issued by or other interest-bearing accounts of any bank or savings and loan institution which are insured by the Federal Deposit Insurance Corporation (FDIC) or which are collateralized, to the extent uninsured, by any obligation permitted by KRS 41.240(4).

G. Capital Assets

Capital assets, which include land, land improvements, buildings, furniture and office equipment, building improvements, machinery, equipment, and infrastructure assets (roads and bridges) that have a useful life of more than one reporting period based on the government's capitalization policy, are reported in the applicable governmental activities of the government-wide financial statements. Such assets are recorded at acquisition or construction cost or estimated historical cost when purchased or constructed.

MORGAN COUNTY
NOTES TO FINANCIAL STATEMENTS

June 30, 2007

Note 1. Summary of Significant Accounting Policies (Continued)

G. Capital Assets (Continued)

Cost of normal maintenance and repairs that do not add to the value of the asset or materially extend the asset's life are not capitalized. Land and Construction In Progress are not depreciated. Interest incurred during construction is not capitalized. Capital assets and infrastructure are depreciated using the straight-line method of depreciation over the estimated useful life of the asset.

	<u>Capitalization Threshold</u>	<u>Useful Life (Years)</u>
Land Improvements	\$ 25,000	10-60
Buildings and Building Improvements	25,000	10-75
Machinery and Equipment	2,500	3-25
Vehicles	2,500	5 - 7
Infrastructure	20,000	2-40

H. Long-term Obligations

In the government-wide financial statements and proprietary fund types in the fund financial statements, long term debt and other long-term obligations are reported as liabilities in the applicable financial statements. The principal amount of bonds, notes and financing obligations are reported.

In the fund financial statements, governmental fund types recognize bond interest, as well as bond issuance cost when received or when paid, during the current period. The principal amount of the debt and interest is reported as expenditures. Issuance costs, whether or not withheld from the actual debt proceeds received, are reported as expenditures. Debt proceeds received are reported as other financing sources.

I. Fund Equity

In the fund financial statements, the difference between the assets and liabilities of governmental funds is reported as fund balance. Fund balance is divided into reserved and unreserved components, with unreserved considered available for new spending. Unreserved fund balances, may be divided into designated and undesignated portions. Designations represent fiscal court's intended use of the resources and should reflect actual plans approved by the fiscal court.

Governmental funds report reservations of fund balance for amounts that are legally restricted by outside parties for use for a specific purpose, long-term receivables, and encumbrances. "Reserved for Encumbrances" are purchase orders that will be fulfilled in a subsequent fiscal period. Although the purchase order or contract creates a legal commitment, the fiscal court incurs no liability until performance has occurred on the part of the party with whom the fiscal court has entered into the arrangement. When a government intends to honor outstanding commitments in subsequent periods, such amounts are encumbered. Encumbrances lapse at year-end and are not reflected on the Statement of Net Assets and Statement of Activities; however, encumbrances are reflected on the Balance Sheet - Governmental Funds as part of the fund balance.

MORGAN COUNTY
NOTES TO FINANCIAL STATEMENTS

June 30, 2007

Note 1. Summary of Significant Accounting Policies (Continued)

J. Budgetary Information

Annual budgets are adopted on a cash basis of accounting and according to the laws of Kentucky as required by the State Local Finance Officer.

The County Judge/Executive is required to submit estimated receipts and proposed expenditures to the fiscal court by May 1 of each year. The budget is prepared by fund, function, and activity and is required to be adopted by the fiscal court by July 1.

The fiscal court may change the original budget by transferring appropriations at the activity level; however, the fiscal court may not increase the total budget without approval by the State Local Finance Officer. Expenditures may not exceed budgeted appropriations at the activity level.

K. Jointly Governed Organizations

A jointly governed organization is an entity that results from a multigovernmental arrangement that is governed by representatives from each participating government. The entity provides services to the citizens of each participating government, but there is no ongoing financial interest or responsibility by the participating government. The jointly governed organization can act independently of each of the participating governments. The Menifee, Morgan, and Rowan Counties Industrial Park (MMRC) meets the criteria noted above and is an organization jointly governed by the Kentucky counties previously mentioned.

Note 2. Deposits

The primary government maintained deposits of public funds with depository institutions insured by the Federal Deposit Insurance Corporation (FDIC) in accordance with KRS 66.480(1)(d). According to KRS 41.240(4), the depository institution should pledge or provide sufficient collateral which, together with FDIC insurance, equals or exceeds the amount of public funds on deposit at all times. In order to be valid against the FDIC in the event of failure or insolvency of the depository institution, this pledge or provision of collateral should be evidenced by an agreement between the county and the depository institution, signed by both parties, that is (a) in writing, (b) approved by the board of directors of the depository institution or its loan committee, which approval must be reflected in the minutes of the board or committee, and (c) an official record of the depository institution.

Custodial Credit Risk – Deposits

Custodial credit risk is the risk that in the event of a depository institution failure, the county's deposits may not be returned to it. The county does not have a deposit policy for custodial credit risk but rather follows the requirements of KRS 41.240(4). As of June 30, 2007, all deposits were covered by FDIC insurance or a properly executed collateral security agreement.

MORGAN COUNTY
NOTES TO FINANCIAL STATEMENTS

June 30, 2007

Note 3. Capital Assets

Capital assets activity for the year ended June 30, 2007 was as follows:

	Reporting Entity			
	Beginning Balance	Increases	Decreases	Ending Balance
Primary Government:				
<u>Governmental Activities:</u>				
Capital Assets Not Being Depreciated:				
Land	\$ 2,222,164	\$ 50,000	\$	\$ 2,272,164
Construction In Progress		52,345		52,345
Total Capital Assets Not Being Depreciated	2,222,164	102,345	0	2,324,509
Capital Assets, Being Depreciated:				
Land Improvements	2,157,555			2,157,555
Buildings	9,357,608	100,000		9,457,608
Furnishings	28,264	4,506		32,770
Equipment and Vehicles	1,307,092	15,416		1,322,508
Infrastructure	9,714,428	861,823		10,576,251
Total Capital Assets Being Depreciated	22,564,947	981,745	0	23,546,692
Less Accumulated Depreciation For:				
Land Improvements	(334,914)	(53,804)		(388,718)
Buildings	(1,976,109)	(213,015)		(2,189,124)
Furnishings	(4,168)	(2,848)		(7,016)
Equipment and Vehicles	(351,361)	(169,384)		(520,745)
Infrastructure	(2,711,124)	(427,849)		(3,138,973)
Total Accumulated Depreciation	(5,377,676)	(866,900)	0	(6,244,576)
Total Capital Assets, Being Depreciated, Net	17,187,271	114,845	0	17,302,116
Governmental Activities Capital Assets, Net	<u>\$ 19,409,435</u>	<u>\$ 217,190</u>	<u>\$ 0</u>	<u>\$ 19,626,625</u>

MORGAN COUNTY
NOTES TO FINANCIAL STATEMENTS

June 30, 2007

Note 3. Capital Assets (Continued)

Depreciation expense was charged to functions of the primary government as follows:

General Government	\$ 196,779
Protection to Persons and Property	64,244
General Health and Sanitation	39,185
Recreation and Culture	53,647
Roads	490,986
Capital Projects	<u>22,059</u>
 Total Depreciation Expense – Governmental Activities	 <u>\$ 866,900</u>

Note 4. Long-term Debt

- A. On June 27, 2000, the Morgan County Fiscal Court entered into a lease agreement with the Kentucky Association of Counties in the amount of \$2,500,000 for road improvements on certain designated county roads. The agreement requires variable monthly payments for 240 months to be paid in full November 20, 2019 with an interest rate of 4.250% plus administrative fees. The principal balance of the agreement was \$1,831,716 as of June 30, 2007. Lease payments for the remaining years are:

<u>Fiscal Year Ended June 30</u>	<u>Scheduled Interest & Admin. Fees</u>	<u>Scheduled Principal</u>
2008	\$ 88,986	\$ 117,486
2009	83,644	114,235
2010	77,934	120,083
2011	70,300	126,229
2012	65,328	132,690
2013-2017	212,262	772,551
2018-2019	30,192	448,442
Totals	<u>\$ 628,646</u>	<u>\$ 1,831,716</u>

MORGAN COUNTY
NOTES TO FINANCIAL STATEMENTS

June 30, 2007

Note 4. Long-term Debt (Continued)

- B. On December 20, 2001, the Morgan County Fiscal Court entered into a lease agreement with the Kentucky Association of Counties in the amount of \$1,500,000 for road improvements on certain designated county roads. The agreement requires variable monthly payments for 240 months to be paid in full December 20, 2021 with an interest rate of 4.250% plus administrative fees. The principal balance of the agreement was \$1,196,870 as of June 30, 2007. Lease payments for the remaining years are:

Fiscal Year Ended June 30	Scheduled Interest & Admin. Fees	Scheduled Principal
2008	\$ 57,660	\$ 62,508
2009	54,765	60,725
2010	51,731	63,779
2011	48,513	66,986
2012	45,785	70,355
2013-2017	169,569	408,545
2018-2021	56,910	463,972
Totals	<u>\$ 484,933</u>	<u>\$ 1,196,870</u>

- C. On April 19, 2002, the Morgan County Fiscal Court entered into a lease agreement with the Kentucky Association of Counties in the amount of \$2,260,000 for the building of a new library. The agreement requires variable monthly payments for 240 months to be paid in full January 20, 2021 with an interest rate of 4.640% plus administrative fees. The principal balance of the agreement was \$1,746,904 as of June 30, 2007. Lease payments for the remaining years are:

Fiscal Year Ended June 30	Scheduled Interest & Admin. Fees	Scheduled Principal
2008	\$ 94,705	\$ 85,135
2009	90,092	89,926
2010	85,217	94,985
2011	80,067	100,328
2012	74,628	105,970
2013-2017	279,060	632,275
2018-2021	88,701	638,285
Totals	<u>\$ 792,470</u>	<u>\$ 1,746,904</u>

- D. On January 14, 2003, the Morgan County Fiscal Court entered into a lease agreement with the Kentucky Association of Counties in the amount of \$83,000 for the purchase of vehicles for the sheriff's department. The agreement requires variable monthly payments for 60 months to be paid in full February 20, 2007. As of June 30, 2007 this lease was paid in full.

MORGAN COUNTY
NOTES TO FINANCIAL STATEMENTS

June 30, 2007

Note 4. Long-term Debt (Continued)

- E. On April 28, 2003, the Morgan County Fiscal Court entered into a lease agreement with the Kentucky Association of Counties in the amount of \$440,000 for the purchase of road equipment. The agreement requires variable monthly payments for 60 months to be paid in full May 20, 2011 with an interest rate of 3.150% plus administrative fees. The principal balance of the agreement was \$234,000 as of June 30, 2007. Lease payments for the remaining years are:

Fiscal Year Ended June 30	Scheduled Interest & Admin. Fees	Scheduled Principal
2008	\$ 8,312	\$ 56,000
2009	6,070	57,000
2010	3,806	59,000
2011	1,436	62,000
Totals	<u>\$ 19,624</u>	<u>\$ 234,000</u>

- F. On April 15, 2005, the Morgan County Fiscal Court entered into a lease agreement with the Kentucky Association of Counties in the amount of \$175,000 for the purchase of vehicles and mowing equipment. The agreement requires variable monthly payments for 48 months to be paid in full May 20, 2009 with an interest rate of 4.25% plus administrative fees. The principal balance of the agreement was \$71,703 as of June 30, 2007. Lease payments for the remaining years are:

Fiscal Year Ended June 30	Scheduled Interest & Admin. Fees	Scheduled Principal
2008	\$ 2,721	\$ 37,810
2009	910	33,893
Totals	<u>\$ 3,631</u>	<u>\$ 71,703</u>

- G. On April 8, 2005, the Morgan County Fiscal Court entered into a lease agreement with the Kentucky Association of Counties in the amount of \$76,839 for the Ambulance Service. The agreement requires variable monthly payments for 48 months to be paid in full April 20, 2009 with an interest rate of 4.25% plus administrative fees. The principal balance of the agreement was \$27,070 as of June 30, 2007. Lease payments for the remaining years are:

Fiscal Year Ended June 30	Scheduled Interest & Admin. Fees	Scheduled Principal
2008	\$ 1,433	\$ 19,799
2009	422	7,271
Totals	<u>\$ 1,855</u>	<u>\$ 27,070</u>

MORGAN COUNTY
NOTES TO FINANCIAL STATEMENTS

June 30, 2007

Note 4. Long-term Debt (Continued)

H. On November 14, 2006, the Morgan County Fiscal Court entered into a lease agreement with the Kentucky Association of Counties in the amount of \$50,000 for the Ambulance Service. The agreement requires variable monthly payments for 48 months to be paid in full November 20, 2010 with an interest rate of 3.54% plus administrative fees. The principal balance of the agreement was \$43,000 as of June 30, 2007. Lease payments for the remaining years are:

<u>Fiscal Year Ended</u> <u>June 30</u>	<u>Scheduled Interest</u> <u>& Admin. Fees</u>	<u>Scheduled</u> <u>Principal</u>
2008	\$ 1,741	\$ 12,000
2009	1,310	12,000
2010	794	12,000
2011	176	7,000
Totals	<u>\$ 4,021</u>	<u>\$ 43,000</u>

I. Changes In Long-term Liabilities

Long-term liability activity for the year ended June 30, 2007, was as follows:

	<u>Beginning</u> <u>Balance</u>	<u>Additions</u>	<u>Reductions</u>	<u>Ending</u> <u>Balance</u>	<u>Due Within</u> <u>One Year</u>
Primary Government:					
<u>Governmental Activities:</u>					
Financing Obligations	<u>\$ 5,497,825</u>	<u>\$ 50,000</u>	<u>\$ 396,562</u>	<u>\$ 5,151,263</u>	<u>\$ 390,738</u>
Governmental Activities					
Long-term Liabilities	<u>\$ 5,497,825</u>	<u>\$ 50,000</u>	<u>\$ 396,562</u>	<u>\$ 5,151,263</u>	<u>\$ 390,738</u>

Note 5. Interest On Long-term Debt and Financing Obligations

Debt Service on the Statement of Activities includes \$259,418 in interest on financing obligations.

Note 6. Operating Lease

On May 20, 2003, the Morgan County Fiscal Court entered into a lease agreement with Fifth-Third Auto Leasing Trust for the use of a 2003 GMC Yukon. The principal amount of the lease was \$39,829. The agreement required an upfront payment of \$3,643 and requires monthly payments of \$608 for 60 months to be paid in full April 20, 2008. The principal balance of the agreement was \$7,530 as of June 30, 2007.

The Fiscal Court has a purchase option at the end of the lease. If all monthly payments have been made and no amounts are outstanding, the amount agreed upon per the agreement is \$11,131.

MORGAN COUNTY
NOTES TO FINANCIAL STATEMENTS

June 30, 2007

Note 7. Receivable

The Morgan County Fiscal Court entered into a financing obligation on behalf of the Morgan County Ambulance Service for the purpose of providing funds for the financing of the purchase of two ambulances. The Morgan County Ambulance Service has agreed to pay all debt service requirements on the obligations. Future amounts due to the Morgan County Fiscal Court are:

<u>Fiscal Year Ended June 30</u>	<u>Governmental Activities</u>
2008	\$ 31,799
2009	19,271
2010	12,000
2011	<u>7,001</u>
Totals	<u>\$ 70,071</u>

Note 8. Related Party Transactions

Tommy Phipps, the Morgan County Treasurer, also serves as treasurer for the Morgan County Ambulance Service, a sub-recipient of State Grant Funds. Mr. Phipps is also an employee of the depository where the County's cash and investments are held.

The County purchases gasoline from a gas station owned by Steve O'Connor, Morgan County Attorney. The amount of gas purchased for the 2007 fiscal year was \$364.

Note 9. Employee Retirement System

The county has elected to participate in the County Employees Retirement System (CERS), pursuant to KRS 78.530 administered by the Board of Trustees of the Kentucky Retirement Systems. This is a cost sharing multiple-employer defined benefit plan, which covers all eligible full-time employees and provides for retirement, disability and death benefits to plan members. Benefit contributions and provisions are established by statute. Nonhazardous covered employees are required to contribute 5.0 percent of their salary to the plan. The county's contribution rate for nonhazardous employees was 13.19 percent. Hazardous covered employees are required to contribute 8.0 percent of their salary to the plan. The county's contribution rate for hazardous employees was 28.21 percent.

Benefits fully vest on reaching five years of service for nonhazardous employees. Aspects of benefits for nonhazardous employees include retirement after 27 years of service or age 65. Aspects of benefits for hazardous employees include retirement after 20 years of service or age 55.

Historical trend information showing the CERS' progress in accumulating sufficient assets to pay benefits when due is present in the Kentucky Retirement Systems' annual financial report. This report may be obtained by writing the Kentucky Retirement Systems, 1260 Louisville Road, Frankfort, KY 40601-6124, or by telephone at (502) 564-4646.

MORGAN COUNTY
NOTES TO FINANCIAL STATEMENTS

June 30, 2007

Note 10. Deferred Compensation

The Morgan County Fiscal Court voted to allow all eligible employees to participate in deferred compensation plans administered by the Kentucky Public Employees' Deferred Compensation Authority. The Kentucky Public Employees' Deferred Compensation Authority is authorized under KRS 18A.230 to 18A.275 to provide administration of tax sheltered supplemental retirement plans for all state, public, school and university employees and employees of local political subdivisions that have elected to participate.

These deferred compensation plans permit all full-time employees to defer a portion of their salary until future years. The deferred compensation is not available to employees until termination, retirement, death, or unforeseeable emergency. Participation by eligible employees in the deferred compensation plans is voluntary.

Historical trend information showing the Kentucky Public Employees' Deferred Compensation Authority's progress in accumulating sufficient assets to pay benefits when due is presented in the Kentucky Public Employees' Deferred compensation Authority's annual financial report. This report may be obtained by writing Kentucky Public Employees' Deferred compensation Authority at 101 Sea Hero Road, Suite 110, Frankfort KY 40601-8862, or by telephone at (502) 573 -7925

Note 11. Insurance

For the fiscal year ended June 30, 2007, Morgan County was a member of the Kentucky Association of Counties' All Lines Fund (KALF). KALF is a self-insurance fund and was organized to obtain lower cost coverage for general liability, property damage, public officials' errors and omissions, public liability, and other damages. The basic nature of a self-insurance program is that of a collectively shared risk by its members. If losses incurred for covered claims exceed the resources contributed by the members, the members are responsible for payment of the excess losses.

Note 12. Commitments

As of June 30, 2007, the County has encumbered \$37,434 and \$49,418 more than the available cash balances in the Road Fund and Jail Fund, respectively.

Note 13. Contingency

The fiscal court was awarded a \$990,000 bridge improvement grant. These funds are 100% federal funds, and are subject to the Davis Bacon Act. The county contracted with bridge contractors to perform the bridge improvements on various county bridges at a cost of \$375,000 and failed to inform the contractors that this project was a federally funded project. The fiscal court was unaware that the Davis Bacon Act was applicable to these projects. Therefore, the contractor's employees were not paid prevailing wages. This has created a contingent liability equal to the difference between the actual amount paid the employees and the prevailing wage rate that should have been paid. There is \$615,000 remaining on the grant that can be used to fund the correction to the wages. It has not been determined as of the date of this report, the actual cost of correcting the wages to be in compliance with the Davis Bacon Act.

MORGAN COUNTY
NOTES TO FINANCIAL STATEMENTS

June 30, 2007

Note 14. Subsequent Events

The following actions were taken subsequent to June 30, 2007:

- 1) Local Government Economic Development Fund projects were frozen until a balanced budget is presented.
- 2) Authorization for General Fund and Road Fund to borrow \$13,000 and \$19,000 respectively to pay payroll and required bills.
- 3) Approval to accept Kentucky Advanced Revenue Funds into the Fiscal Year Ended June 30, 2008 budget so that these funds can be immediately loaned to the General Fund and Road Fund to be used as necessary to pay unpaid bills.
- 4) Approval to borrow a short-term loan in the amount of \$250,000.

Note 15. Prior Period Adjustments

The beginning net asset balances as of June 30, 2006 for governmental activities of the Morgan County Fiscal Court have been restated due to the correction of errors. The following is a reconciliation of net assets as of June 30, 2006, as previously reported to the restated net assets balance for the same period.

Beginning Balance	\$ 14,272,475
Adjustment for Prior Year Voided Checks (a)	13,523
Adjustment for Accounts Receivable (b)	<u>(4,252)</u>
Restated Beginning Balance	<u>\$ 14,281,746</u>

- (a) The beginning fund balance of the General Fund was increased by \$13,523 from \$231,877 to \$245,400 to account for a voided check.
- (b) The interest associated with the Ambulance Service Leases was included in Accounts Receivable from Ambulance Service, but not in the Liability. Therefore, the county's Net Assets were overstated by \$4,252.

MORGAN COUNTY
BUDGETARY COMPARISON SCHEDULES
Required Supplemental Information – Modified Cash Basis
For The Year Ended June 30, 2007

MORGAN COUNTY
BUDGETARY COMPARISON SCHEDULES
Required Supplemental Information - Modified Cash Basis

For The Year Ending June 30, 2007

	GENERAL FUND			
	Budgeted Amounts		Actual Amounts, (Budgetary Basis)	Variance with Final Budget Positive (Negative)
	Original	Final		
REVENUES				
Taxes	\$ 541,800	\$ 584,322	\$ 605,479	\$ 21,157
In Lieu Tax Payments	28,000	28,000	28,820	820
Excess Fees		15,121	15,121	0
License and Permits		2,362	2,577	215
Intergovernmental	4,019,285	4,781,848	3,010,851	(1,770,997)
Charges for Services		117,080	117,080	0
Miscellaneous	135,570	207,273	161,903	(45,370)
Interest	20,500	20,500	3,510	(16,990)
Total Revenues	4,745,155	5,756,506	3,945,341	(1,811,165)
EXPENDITURES				
General Government	549,750	780,515	694,485	86,030
Protection to Persons and Property	199,900	178,087	142,777	35,310
General Health and Sanitation	195,900	208,643	118,530	90,113
Social Services		5,000	5,000	0
Recreation and Culture	48,091	33,891	1,460	32,431
Roads		205,000		205,000
Debt Service	243,007	254,060	246,373	7,687
Capital Projects	3,673,200	3,955,449	2,554,572	1,400,877
Administration	298,781	421,747	297,960	123,787
Total Expenditures	5,208,629	6,042,392	4,061,157	1,981,235
Excess (Deficiency) of Revenues Over Expenditures Before Transfers and Other Financing Sources (Uses)	(463,474)	(285,886)	(115,816)	170,070
TRANSFERS & OTHER FINANCING SOURCES (USES)				
Transfers from Other Funds	186,790	186,790	186,790	0
Transfers to Other Funds	(98,316)	(48,131)	(94,000)	(45,869)
Total Transfers & Other Financing Sources (Uses)	88,474	138,659	92,790	(45,869)
Net Change in Fund Balance	(375,000)	(147,227)	(23,026)	124,201
Fund Balance, Beginning (Restated)	375,000	231,877	245,400	13,523
Fund Balance, Ending	\$ 0	\$ 84,650	\$ 222,374	\$ 137,724

The accompanying notes are an integral part of the financial statements.

MORGAN COUNTY
BUDGETARY COMPARISON SCHEDULES
Required Supplemental Information - Modified Cash Basis
For The Year Ended June 30, 2007 (Continued)

ROAD FUND				
	Budgeted Amounts		Actual	Variance with
	Original	Final	Amounts, (Budgetary Basis)	Final Budget Positive (Negative)
REVENUES				
In Lieu Tax Payments	\$ 13,500	\$ 19,144	\$ 19,144	\$ 0
Intergovernmental Revenue	2,346,625	2,725,402	1,951,718	(773,684)
Charges for Services	170,000	170,000	160,000	(10,000)
Miscellaneous	16,500	19,490	18,670	(820)
Interest	4,500	4,500	1,982	(2,518)
Total Revenues	2,551,125	2,938,536	2,151,514	(787,022)
EXPENDITURES				
Roads	591,150	648,648	612,771	35,877
Debt Service	427,100	432,475	388,798	43,677
Capital Projects	1,290,000	1,549,590	862,742	686,848
Administration	236,085	224,473	211,308	13,165
Total Expenditures	2,544,335	2,855,186	2,075,619	779,567
Excess (Deficiency) of Revenues Over Expenditures Before Transfers and Other Financing Sources (Uses)	6,790	83,350	75,895	(7,455)
TRANSFERS & OTHER FINANCING SOURCES (USES)				
Transfers from Other Funds	30,000	30,000	45,051	15,051
Transfers to Other Funds	(186,790)	(186,790)	(186,790)	0
Total Transfers & Other Financing Sources (Uses)	(156,790)	(156,790)	(141,739)	15,051
Net Changes in Fund Balance	(150,000)	(73,440)	(65,844)	7,596
Fund Balance - Beginning	150,000	68,790	68,790	0
Fund Balance - Ending	\$ 0	\$ (4,650)	\$ 2,946	\$ 7,596

The accompanying notes are an integral part of the financial statements.

MORGAN COUNTY
BUDGETARY COMPARISON SCHEDULES
Required Supplemental Information - Modified Cash Basis
For The Year Ended June 30, 2007 (Continued)

	JAIL FUND			
	Budgeted Amounts		Actual Amounts, (Budgetary Basis)	Variance with Final Budget Positive (Negative)
	Original	Final		
REVENUES				
Intergovernmental Revenue	\$ 68,178	\$ 73,107	\$ 76,534	\$ 3,427
Charges for Services	60,000	60,000		(60,000)
Miscellaneous	100	100	61	(39)
Interest	100	100	67	(33)
Total Revenues	128,378	133,307	76,662	(56,645)
EXPENDITURES				
Protection to Persons and Property	369,026	403,316	336,465	66,851
Administration	23,668	23,668	22,197	1,471
Total Expenditures	392,694	426,984	358,662	68,322
Excess (Deficiency) of Revenues Over Expenditures Before Transfers and Other Financing Sources (Uses)	(264,316)	(293,677)	(282,000)	11,677
TRANSFERS & OTHER FINANCING SOURCES (USES)				
Transfers from Other Funds	263,816	213,631	291,512	77,881
Total Transfers & Other Financing Sources (Uses)	263,816	213,631	291,512	77,881
Net Changes in Fund Balance	(500)	(80,046)	9,512	89,558
Fund Balance - Beginning (Restated)	500	46	46	0
Fund Balance - Ending	\$ 0	\$ (80,000)	\$ 9,558	\$ 89,558

The accompanying notes are an integral part of the financial statements.

MORGAN COUNTY
BUDGETARY COMPARISON SCHEDULES
Required Supplemental Information - Modified Cash Basis
For The Year Ended June 30, 2007 (Continued)

LOCAL GOVERNMENTAL ECONOMIC ASSISTANCE (LGEA) FUND

	Budgeted Amounts		Actual Amounts, (Budgetary Basis)	Variance with Final Budget Positive (Negative)
	Original	Final		
<u>REVENUES</u>				
Intergovernmental Revenue	\$ 195,000	\$ 245,170	\$ 242,380	\$ (2,790)
Interest	500	500	283	(217)
Total Revenues	195,500	245,670	242,663	(3,007)
<u>EXPENDITURES</u>				
Administration		7,765		7,765
Total Expenditures	0	7,765	0	7,765
Excess (Deficiency) of Revenues Over Expenditures Before Transfers and Other Financing Sources (Uses)	195,500	237,905	242,663	4,758
<u>TRANSFERS & OTHER FINANCING SOURCES (USES)</u>				
Transfers to Other Funds	(195,500)	(237,905)	(242,563)	(4,658)
Total Transfers & Other Financing Sources (Uses)	(195,500)	(237,905)	(242,563)	(4,658)
Net Changes in Fund Balance	0	0	100	100
Fund Balance - Beginning				
Fund Balance - Ending	\$ 0	\$ 0	\$ 100	\$ 100

The accompanying notes are an integral part of the financial statements.

MORGAN COUNTY
BUDGETARY COMPARISON SCHEDULES
Required Supplemental Information - Modified Cash Basis
For The Year Ended June 30, 2007 (Continued)

	FORESTRY FUND			
	Budgeted Amounts		Actual Amounts, (Budgetary Basis)	Variance with Final Budget Positive (Negative)
	Original	Final		
REVENUES				
Taxes	\$ 3,500	\$ 3,500	\$ 2,737	\$ (763)
Interest	20	20	11	(9)
Total Revenues	3,520	3,520	2,748	(772)
EXPENDITURES				
Protection to Persons and Property	3,520	3,520	2,656	864
Total Expenditures	3,520	3,520	2,656	864
Excess (Deficiency) of Revenues Over Expenditures Before Transfers and Other Financing Sources (Uses)	0	0	92	92
Net Changes in Fund Balance	0	0	92	92
Fund Balance - Beginning				
Fund Balance - Ending	\$ 0	\$ 0	\$ 92	\$ 92

The accompanying notes are an integral part of the financial statements.

MORGAN COUNTY
NOTES TO REQUIRED SUPPLEMENTARY INFORMATION

June 30, 2007

Budgetary Information

Annual budgets are adopted on a cash basis of accounting and according to the laws of Kentucky as required by the State Local Finance Officer.

The County Judge/Executive is required to submit estimated receipts and proposed expenditures to the fiscal court by May 1 of each year. The budget is prepared by fund, function, and activity and is required to be adopted by the fiscal court by July 1.

The fiscal court may change the original budget by transferring appropriations at the activity level; however, the fiscal court may not increase the total budget without approval by the State Local Finance Officer. Expenditures may not exceed budgeted appropriations at the activity level.

2. Reconciliation of budgetary schedules to the statement of Revenues, Expenditures, and Changes in Fund Balance – Governmental Funds – Modified Cash Basis

	<u>Other Financing Sources/(Uses)</u>	<u>Expenditures</u>
General Fund		
Budgetary Comparison		
Schedule	\$ 92,790	\$ 4,061,157
Capital Lease Proceeds	50,000	
Capital Outlay Associated With Capital Lease		50,000
	<u>142,790</u>	<u>4,111,157</u>
Governmental Funds – Modified Cash Basis	<u>\$ 142,790</u>	<u>\$ 4,111,157</u>

	<u>Debt Service</u>	<u>Capital Projects</u>
General Fund		
Budgetary Comparison		
Schedule	\$ 246,373	\$ 2,554,572
Reclassification	27,500	(27,500)
	<u>273,873</u>	<u>2,527,072</u>
Governmental Funds – Modified Cash Basis	<u>\$ 273,873</u>	<u>\$ 2,527,072</u>

MORGAN COUNTY
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS

For The Fiscal Year Ended June 30, 2007

Federal Grantor
Program Title
Grant Name (CFDA #)

Cash Programs:	<u>Pass-Through Grantor's Number</u>	<u>Expenditures</u>
U.S. Department of Education Passed-Through the University of Kentucky Research Foundation Technology Innovation Challenge Grants - (CFDA #84.303K)	Not Available	\$ 328,496
U.S. Department of Homeland Security Passed-Through State Department of Military Affairs: Emergency Management Performance Grants - (CFDA #97.042) Division of Emergency Services Coordinator Salary	Not Available	14,832
Public Assistance Grants - (CFDA #97.036) Severe Weather	Not Available	<u>3,114</u>
Total U.S. Department of Homeland Security		17,946
U.S. Department of Commerce Passed Through East Kentucky Pride Inc. Congresionally Identified Awards & Projects Pride Grant (CFDA #11.469)		258
U.S. Environmental Protection Agency Congressionally Mandated Projects (CFDA #66.202)	Not Available	1,505,555
United States Department of Transportation Passed Through State Department of Highways Highway Planning And Construction - (CFDA #20.205)	Not Available	<u>375,000</u>
Total Cash Expenditures Of Federal Awards		<u><u>\$ 2,227,255</u></u>

MORGAN COUNTY
NOTES TO THE SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
Fiscal Year Ended June 30, 2007

Note 1 - The accompanying Schedule of Expenditures of Federal Awards includes the federal grant activity of Morgan County, Kentucky and is presented on a modified cash basis of accounting. The information in this schedule is presented in accordance with the requirements of OMB Circular A-133, Audits of States, Local Governments, and Non-Profit Organizations.

Note 2 - Of the federal expenditures presented in the accompanying Schedule of Expenditures of Federal Awards, Morgan County Fiscal Court provided federal awards to the following sub recipient:

<u>Program</u>	<u>CFDA #</u>	<u>Subrecipient</u>	<u>Pass-through Grant Amount</u>
U.S. EPA Congressionally Mandated Projects	66.202	City of West Liberty	\$ 1,505,555
U.S. Department Of Education, Technology Innovation Challenge Grant	84.303K	University Of Kentucky Foundation	\$ 328,496

**REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND
ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL
STATEMENTS PERFORMED IN ACCORDANCE WITH GOVERNMENT AUDITING
STANDARDS**

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The Honorable Tim Conley, Morgan County Judge/Executive
Members of the Morgan County Fiscal Court

Report On Internal Control Over Financial Reporting And On Compliance And Other Matters Based On An Audit Of Financial Statements Performed In Accordance With *Government Auditing Standards*

We have audited the financial statements of the governmental activities and each major fund of the Morgan County Fiscal Court, as of and for the year ended June 30, 2007, which collectively comprise the County's basic financial statements and have issued our report thereon dated September 21, 2007. The Morgan County Fiscal Court presents its financial statements on the modified cash basis of accounting, which is a comprehensive basis of accounting other than generally accepted accounting principles. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the County's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the County's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the County's internal control over financial reporting.

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and would not necessarily identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses. However, as discussed below, we identified a deficiency in internal control over financial reporting that we consider to be a significant deficiency.

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the County's ability to initiate, authorize, record, process, or report financial data reliably in accordance with the modified cash basis of accounting such that there is more than a remote likelihood that a misstatement of the County's financial statements that is more than inconsequential will not be prevented or detected by the County's internal control. We consider the deficiency described in the accompanying schedule of findings and questioned costs to be a significant deficiency in internal control over financial reporting.

- 2007-3 The County Should Make Contractors Aware Of All Compliance Requirements Associated With Project Funding

Report On Internal Control Over Financial Reporting
And On Compliance And Other Matters Based On An Audit Of Financial
Statements Performed In Accordance With Government Auditing Standards
(Continued)

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the County's internal control.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in the internal control that might be significant deficiencies and, accordingly, would not necessarily disclose all significant deficiencies that are also considered to be material weaknesses. However, we consider the significant deficiency described above to be a material weakness.

Compliance And Other Matters

As part of obtaining reasonable assurance about whether the Morgan County Fiscal Court's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards* and which are described in the accompanying schedule of findings and questioned costs as items:

- 2007-1 The County Should Provide Retirement Compensation To All Employees That Work An Average Of 100 Hours Per Month
- 2007-2 The County Should Pay Invoices Within Thirty Days Of Receipt Of A Vendor's Invoice
- 2007-3 The County Should Make Contractors Aware Of All Compliance Requirements Associated With Project Funding
- 2007-4 The County Should Pay All Debt Expenditures Timely

The Morgan County Judge/Executive's responses to the findings identified in our audit are included in the accompanying schedule of findings and questioned costs. We did not audit the County Judge/Executive's responses and, accordingly, we express no opinion on them.

This report is intended solely for the information and use of management, members of the fiscal court, the Kentucky Governor's Office for Local Development, federal awarding agencies, and pass-through entities and is not intended to be and should not be used by anyone other than the specified parties.

Respectfully submitted,

Morgan - Franklin, LLC

Morgan-Franklin, LLC

September 21, 2007

**REPORT ON COMPLIANCE WITH REQUIREMENTS
APPLICABLE TO EACH MAJOR PROGRAM AND ON INTERNAL
CONTROL OVER COMPLIANCE IN ACCORDANCE WITH OMB CIRCULAR A-133**

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The Honorable Tim Conley, Morgan County Judge/Executive
Members of the Morgan County Fiscal Court

Report On Compliance With Requirements
Applicable To Each Major Program And On Internal Control
Over Compliance In Accordance With OMB Circular A-133

Compliance

We have audited the compliance of the Morgan County Fiscal Court, with the types of compliance requirements described in the U.S. Office of Management and Budget (OMB) *Circular A-133 Compliance Supplement* that are applicable to each of its major federal programs for the year ended June 30, 2007. The Morgan County Fiscal Court's major federal programs are identified in the summary of auditor's results section of the accompanying schedule of findings and questioned costs. Compliance with the requirements of laws, regulations, contracts, and grants applicable to each of its major federal programs is the responsibility of Morgan County Fiscal Court's management. Our responsibility is to express an opinion on Morgan County Fiscal Court's compliance based on our audit.

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about the Morgan County Fiscal Court's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination of the Morgan County Fiscal Court's compliance with those requirements.

As described in item 2007-3 in the accompanying schedule of findings and questioned costs, the Morgan County Fiscal Court did not comply with requirements regarding the Davis Bacon Act that are applicable to its Federal Highway Administration Grant CFDA # 20.205. Compliance with such requirements is necessary, in our opinion, for the Morgan County Fiscal Court to comply with the requirements applicable to that program.

In our opinion, except for the noncompliance described in the preceding paragraph, the Morgan County Fiscal Court complied, in all material respects, with the requirements referred to above that are applicable to each of its major federal programs for the year ended June 30, 2007.

Report On Compliance With Requirements
Applicable To Each Major Program And On Internal Control
Over Compliance In Accordance With OMB Circular A-133
(Continued)

Internal Control Over Compliance

The management of the Morgan County Fiscal Court is responsible for establishing and maintaining effective internal control over compliance with the requirements of laws, regulations, contracts, and grants applicable to federal programs. In planning and performing our audit, we considered the Morgan County Fiscal Court's internal control over compliance with the requirements that could have a direct and material effect on a major federal program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of the Morgan County Fiscal Court's internal control over compliance.

Our consideration of internal control over compliance was for the limited purpose described in the preceding paragraph and would not necessarily identify all deficiencies in the entity's internal control that might be significant deficiencies or material weaknesses as defined below. However, as discussed below, we identified a deficiency in internal control over compliance that we consider to be a significant deficiency and a material weakness.

A *control deficiency* in an entity's internal control over compliance exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect noncompliance with a type of compliance requirement of a federal program on a timely basis. A *significant deficiency* is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to administer a federal program such that there is more than a remote likelihood that a noncompliance with a type of compliance requirement of a federal program that is more than inconsequential will not be prevented or detected by the entity's internal control. We consider the deficiency in internal control over compliance described in the accompanying schedule of findings and questioned costs as item 2007-3 to be a significant deficiency.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material noncompliance with a type of compliance requirement of a federal program will not be prevented or detected by the entity's internal control. We consider the significant deficiency listed above to be a material weakness.

The Morgan County Fiscal Court's response to the findings identified in our audit are described in the accompanying schedule of findings and questioned costs. We did not audit the Morgan County Fiscal Court's response, and accordingly, we express no opinion on it.

This report is intended solely for the information and use of management, others within the entity, the Kentucky Governor's Office for Local Development, federal awarding agencies, and pass-through entities and is not intended to be and should not be used by anyone other than the specified parties.

Respectfully submitted,

Morgan - Franklin, LLC

Morgan-Franklin, LLC

September 21, 2007

**MORGAN COUNTY
SCHEDULE OF FINDINGS AND QUESTIONED COSTS**

Fiscal Year Ended June 30, 2007

A. SUMMARY OF AUDIT RESULTS

1. The auditors' report expresses an unqualified opinion on the governmental activities and each major fund of Morgan County, Kentucky.
2. One significant control deficiency relating to the audit of the financial statements is reported in the Independent Auditors' Report. We consider this deficiency to be a material weakness.
3. Four instances of noncompliance material to the financial statements of Morgan County were disclosed during the audit.
4. One significant control deficiency relating to the audit of the major federal award programs is reported in the Independent Auditors' Report.
5. The auditors' report on compliance for the audit of the major federal award programs for Morgan County expresses a qualified opinion.
6. Audit findings that are required to be reported in accordance with Section 510(a) of OMB Circular A-133 are reported in Part C of this schedule.
7. The programs tested as major programs include: U.S. Department of Education, Technology Innovation Challenge Grants – (CFDA #84.303K), U.S. Environmental Protection Agency, Congressionally Identified Awards and Projects (CFDA #66.202), and Federal Highway Administration, Department of Transportation, Highway Planning and Construction – (CFDA #20.205).
8. The threshold for distinguishing Type A and B programs was \$300,000.
9. Morgan County did not qualify as a low-risk auditee.

B. FINDINGS - FINANCIAL STATEMENT AUDIT

STATE LAWS AND REGULATIONS

2007-1 The County Should Provide Retirement Compensation To All Employees That Work An Average Of 100 Hours Per Month

During our payroll testing, we noted three instances in which employees were working over 100 hours per month; however they were not receiving retirement benefits. Any employee holding a regular, full time position must participate in the County Retirement Plan. Per KRS 78.510(21) Regular full-time positions...shall mean all positions that average one hundred (100) or more hours per month, determined by using the number of hours actually worked in a calendar or fiscal year... We recommend that the County start withholding and matching retirement contributions for all employees that work an average of 100 hours per month.

Morgan County Judge/Executive, Tim Conley's Response: Need to research CERS handbook for definition.

MORGAN COUNTY
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
Fiscal Year Ended June 30, 2007
(Continued)

2007-2 The County Should Pay Invoices Within Thirty Days Of Receipt Of A Vendor's Invoice.

Per KRS 65.140, unless the purchaser and vendor otherwise contract, all bills for goods or services shall be paid within thirty working days of receipt of a vendor's invoice except when payment is delayed because the purchaser had made a written disapproval of improper performances or improper invoicing by the vendor or by the vendor's subcontractor. An interest penalty of one percent (1%) of any amount approved and unpaid shall be added to the amount approved for each month or fraction thereof after the thirty days which followed receipt of vendor's invoice by the purchaser. Of the forty disbursements tested, seven invoices were paid later than the thirty-day requirement. We recommend the fiscal court pay invoices within thirty days as required by KRS 65.140.

Morgan County Judge/Executive, Tim Conley's Response: Having a budget deficit due to jail bills, unfounded mandates and debt services from previous administration has left us short on funds. These invoices were paid when funding was received.

2007-4 The County Should Pay All Debt Expenditures Timely

During our audit we noted that the Morgan County Fiscal Court did not pay their June payment on three KACO leases until after June 30, 2007. We recommend that the County pay all debt expenditures timely in the future.

Morgan County Judge/Executive, Tim Conley's Response: Due to budget short fall, we had to hold some of the invoices for more than 30 days. We were in contact with the debtors, they agreed for us to hold the payments.

SIGNIFICANT CONTROL DEFICIENCY AND MATERIAL WEAKNESS:

2007-3 The County Should Make Contractors Aware Of All Compliance Requirements Associated With Project Funding (See Section C Below)

C. FINDINGS AND QUESTIONED COSTS - MAJOR FEDERAL AWARDS PROGRAM AUDIT

Federal Highway Administration Grant – CFDA # 20.205

2007-3 The County Should Make Contractors Aware Of All Compliance Requirements Associated With Project Funding

Condition and Criteria: The County accepted bids for the repair of various County bridges. The County failed to inform the bidders through the use of advertising and contracts that the project was federally funded and that the Davis-Bacon Act applied.

Effect: The contractor failed to follow the requirements of the Davis-Bacon Act, which resulted in employees not being paid prevailing wage. Money that the County thought would be available for additional bridge projects would need to be used to fund the wage deficit.

MORGAN COUNTY
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
Fiscal Year Ended June 30, 2007
(Continued)

Cause: The County failed to determine the compliance requirements associated with the federal program and to inform the contractor of such compliance requirements.

Auditor's Recommendation: The County should contact the previous contractor and current contractors to inform them of the applicability of the Davis-Bacon Act. Payroll records should be amended to reflect prevailing wage and employees should be paid any differences between original amounts paid and required wages under the Davis-Bacon Act. Future advertising for bids for these bridge projects should include the applicability of the Davis-Bacon Act. The County should monitor contractors' payrolls to ensure compliance.

Morgan County Judge/Executive, Tim Conley's Response: Due to the way the contract was written and the state holding all funding until invoiced by the county, we were not aware of the Davis-Bacon Act.

We will review our previous budget contracts and bid all future contracts with the stipulation that it is to be in compliance with the Davis-Bacon Act.

D. PRIOR YEAR FINDINGS

None

**CERTIFICATION OF COMPLIANCE –
LOCAL GOVERNMENT ECONOMIC ASSISTANCE PROGRAM
MORGAN COUNTY FISCAL COURT**

**For The Fiscal Year Ended
June 30, 2007**

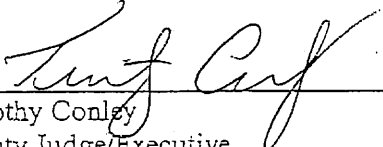
Appendix A

CERTIFICATION OF COMPLIANCE
LOCAL GOVERNMENT ECONOMIC ASSISTANCE PROGRAM

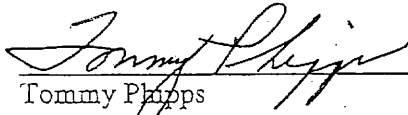
MORGAN COUNTY FISCAL COURT

For The Year Ended June 30, 2007

The Morgan County Fiscal Court hereby certifies that assistance received from the Local Government Economic Assistance Program was expended for the purpose intended as dictated by the applicable Kentucky Revised Statutes.



Timothy Conley
County Judge/Executive



Tommy Phipps
County Treasurer